IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 585

N. SIMS ORGAN & CO., INC. and N. SIMS ORGAN,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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SECURITIES AND EXCHANGE COMMISSION.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

N. Sims Organ & Co., Inc. and N. Sims Organ petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this case on September 19, 1961.

Opinions Below

The opinion of the Court of Appeals (Appendix A, infra, pp. A-1-8) is reported 293 F. 2d 78.

The opinion of the Securities and Exchange Commission, — SEC —, is not yet reported (Appendix B, infra, pp. B-1-14).

Jurisdiction

The judgment of the Court of Appeals was entered on September 19, 1961 (Appendix C, infra, pp. C-1-2). The jurisdiction of this Court is invoked under Section 25(a) of the Securities Exchange Act of 1934 and 28 U. S. C. 1254.

Questions Presented

1. Whether the Securities and Exchange Commission, after hearing all the evidence in a denial proceeding of a broker-dealer registration and permitting the registration to become effective, has the power, in a revocation proceeding commenced after the effective date, to revoke the broker-dealer registration on the same evidence used in the abortive denial proceeding.

2. Was there a denial of fair hearing under the due process clause of the Constitution in that the Securities and Exchange Commission had prejudged the matter when it had published a release asserting that members of its staff have reported information tending to show that the individual petitioner had violated anti-fraudulent provisions?

Statutes Involved

Securities Exchange Act of 1934 (15 U.S.C. 78o, 78u)

Sec. 15. (b) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to

such broker or dealer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

* * * *

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration if it finds that such denial is in the public interest * * * Pending final determination whether any such registration shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing, it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors.

Sec. 21. (a) The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated or is

about to violate any provision of this title or any rule or regulation thereunder, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated. The Commission is authorized, in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of the provisions of this title, in the prescribing of rules and regulations thereunder, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates.

Administrative Procedure Act (5 U.S.C. 1004)

Sec. 5 (c) Separation of Functions.—The same officers who preside at the reception of evidence pursuant to section 7 shall make the recommended decision or initial decision required by section 8 except where such officers become unavailable to the agency. Save to the extent required for the disposition of ex parte matters as authorized by law, no such officer shall consult any person or party on any fact in issue unless upon notice and opportunity for all parties to participate; nor shall such officer be responsible to or subject to the supervision or direction of any officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency. No officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency in any case shall, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review pursuant to

section 8 except as witness or counsel in public proceedings. This subsection shall not apply in determining applications for initial licenses or to proceedings involving the validity or application of rates, facilities, or practices of public utilities or carriers; nor shall it be applicable in any manner to the agency or any member or members of the body comprising the agency.

Statement

J. H. Lederer Co., Inc. had been registered with the SEC as a broker-dealer. Its registration was revoked on December 28, 1958. Organ, the individual petitioner, was a salesman employed by Lederer in 1958, during which period Lederer had sold Continental Mining stock. The petitioner was *not* named the cause for this revocation, although it is customary, where an individual salesman has violated any provision of the Securities Law, resulting in the revocation of his employee registration, to name such salesman as the cause—this, despite the fact that the Staff of the SEC had full knowledge of the facts.

N. Sims Organ & Co., Inc., the corporate petitioner (hereinafter called "Organ & Co."), was organized in January 1959. Its application for registration as a broker-dealer was received by the SEC on October 19, 1959. On November 17, 1959, the SEC instituted a proceeding to determine whether Organ, while employed by Lederer, had violated certain provisions of the Federal Securities Acts.

In the SEC's Daily News Digest of November 23,

1959, a release was entitled "FRAUD CHARGED TO N. SIMS ORGAN CO.", and recited:

> "The SEC has issued an order under the Securities Exchange Act of 1934 postponing the effective date of registration of N. Sims Organ & Co., Inc. * * * as a broker-dealer, and ordering a hearing on whether such registration should be denied * * *. The order of the Commission asserts that members of its staff have reported information obtained as a result of an investigation which tends to show that * * *"

Organ had violated certain statutes.

Of course, Organ & Co. had not even been in existence when the claimed violations occurred. At the hearing (R. 30a-31a), appropriate exception was taken.

The SEC postponed the effective date of Organ & Co.'s application for fifteen days, to December 21, 1959, and directed a hearing to determine whether the effective date of registration should be further postponed pending denial proceedings (R. 16a-18a).

The hearing was held on December 2, 1959, but the SEC did not reach a determination on this question prior to the date on which the application became effective by lapse of time on December 22, 1959. At no time did the Staff of the SEC apply for, nor did the Commission issue, an order postponing the effective date of the registration, to await the recommended decision and final determination of the Commission, as provided for in Section 15(b) of the Securities Exchange Act of 1934.

On December 22, 1959, Organ & Co. became a duly registered broker-dealer.

On January 28, 1960, the SEC dismissed the denial proceeding on the ground that it had become moot. Of course, the registration had become "effective" on December 22, 1959, by force of the statute (R. 20a), and that part of the order dismissing the proceeding as "moot" neither added to nor subtracted from the fact that the registration was effective.

The order of January 28, 1960 (R. 19a-22a) instituted a revocation proceeding which was heard on March 28, 1960, before the same Examiner who heard the denial proceeding. The staff of the SEC stipulated that it would rely on the same oral testimony which was before the Examiner on the denial proceeding (R. 54a).

The Examiner held for the petitioners on the merits, rejecting the staff's evidence as insufficient in law and in fact (R. 24a-29a; 60a-62a).

The SEC reversed the Hearing Examiner's Recommended Decision (R. 22a-29a) and made an order revoking Organ & Co.'s registration as a broker-dealer in securities, and recited that Organ was the cause of the revocation (App. p. B-14). The SEC and the court below relied heavily on the fact that Organ did not take the stand to deny certain hearsay evidence (App. pp. A-5, B-8). Organ was called to the stand by the Staff; he was available for questioning, but the Staff did not see fit to interrogate him as to the disputed issues (R. 50a-52a). The Court of Appeals for the Second Circuit affirmed. On the issue of the effect

of the denial proceeding on the revocation proceeding, it held (App. pp. A-7-8) that "the dismissal of a case because it is moot does not lay a basis for the application of the doctrine of *res judicata*."

It is submitted that the court below gave no effect to the clear wording of the statute that the registration became "effective" on December 22, 1959, irrespective of whether the SEC had made an order dismissing the proceeding as moot or not.

Subsequent to the argument, but before the opinion was handed down, this Court on June 12, 1961, decided *C. A. B.* v. *Delta Air Lines, Inc.*, 367 U. S. 316. Petitioners urged that the cited case is controlling. Petitioners contend that *Delta* controls the case at bar, even though the court below attempted to distinguish it.

REASONS FOR GRANTING THE WRIT

I.

The court below, we submit, has misconstrued pertinent sections of the Securities Exchange Act of 1934, and has misapplied controlling decisions of this Court dealing with parallel problems in administrative law. Thus, it has approved the action of the SEC in exceeding the authority granted to it by Congress with reference to revocation of broker-dealer registrations.

Congress has always been aware of the propensity of administrative bodies to defer action on license applications. In broker-dealer registrations, it evolved an equitable procedure whereby a "registration shall be-

come effective thirty days after the receipt of such application"; and if "it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order".

We believe that the decision of the court below is contrary to the decisions of this Court in *C. A. B.* v. *Delta Lines, Inc.*, 367 U. S. 316, and in *United States* v. *Sea Train Lines*, 329 U. S. 424.

Delta was an affirmance of the decision of the Second Circuit in 280 F. 2d 43. This Court granted the Government's petition for certiorari on the question of whether an administrative body, once it has entered an order permitting a certificate to become effective, is without power to modify the certificate on a petition for reconsideration. In that case, the petition for reconsideration was filed prior to the effective date; in the case at bar, the broker-dealer registration had become effective before the revocation proceeding was commenced.

The opinion by the Chief Justice analyzes the conflict between two opposing policies—finality on the one hand and the right result on the other. Ultimately, it is Congress who must show which path is to be followed. While the statute applicable to each administrative body is "enacted in an attempt to tailor the agency's discretion to the particular problems in the area", yet, the use of similar language and similar procedures often give aid in settling the basic principles involved. Congress was concerned with the possibility that an application might be pigeonholed forever. In the related area of the issuance of securities, *Jones* v.

Securities and Exchange Commission, 298 U. S. 1, 18, this Court has defined the word "effective" as connoting "completeness of operative force and freedom to act". Congress has given the SEC an arsenal of remedies to postpone the effective date, but the onus and burden are on the SEC to take these steps.

This is especially true when a denial proceeding has actually been commenced. Then, it is incumbent upon the SEC to finish what it starts. This is not the case where no denial proceedings had ever been commenced; nor is this a case where a revocation proceeding had been commenced on evidence that had come to the SEC's attention after the broker-dealer registration had become effective. In the situation at bar, the evidence was not only in the SEC's file, but was used in the denial proceeding, and subsequently used as the only evidence in the revocation proceeding.

It is evident that the "power the [SEC asked] for in this case seems nothing more or less than the power to do indirectly what it cannot do directly". *Delta*, at page 328. "All we hold is that if the [SEC] wishes to do so, it must proceed in the manner authorized by statute. * * * if it feels uncertain about the decision prior to its effective date, it may postpone the effective date until all decisions have been resolved; * * *". *Delta*, at page 329. "Indeed, with all these weapons at its hand, it is difficult to follow the argument that the [SEC] should be allowed to improvise on the powers granted by Congress in order to preserve administrative flexibility". *Delta*, at page 330.

Delia relied heavily on *United States* v. *Sea Train Lines*, 329 U. S. 424, affirming 64 F. Supp. 156. The

lower court's opinion (that of a three judge statutory court), relying upon the Fifth Amendment, was cited with approval in *Delta* at page 332.

Circuit Judge Biggs (p. 160) cites *Frost* v. *Corporation Commission*, 278 U. S. 515, and *Owensboro* v. *Cumberland Telephone Co.*, 230 U. S. 58, for the proposition that a certificate allowed to become effective was a franchise because it granted rights to engage in business of a public nature and was thus protected by the Constitution. He, as well as this Court, in affirming, cited *Smith Bros., Revocation of Certificate*, 33 M. C. C. 465, 472, to the effect that once a certificate becomes effective, the administrative body or the courts are without power to cancel. That case has been cited with approval by this Court several times, and was cited by the Second Circuit in *Delta*.

Judge Biggs also relies on the decision of this Court in *International Union, etc.* v. *Eagle-Picher Mining & Smelting Co.*, 325 U. S. 335, 341, where it was said:

> "Administrative flexibility and judicial certainty are not contradictory; there must be an end to disputes which arise between administrative bodies and those over whom they have jurisdiction."

Even if this case is viewed in the aspect of *res judicata* (or more accurately estoppel by judgment) we submit that the doctrine has been tortured beyond reality.

Of course, *Res Judicata* is applicable in administrative law. See Tobias, *Administrative Reconsideration*, 28 N. Y. U. L. Rev. 1262, cited at p. 321, and Davis, *Res Judicata in Administrative Law*, 25 Texas L. Rev. 199, cited at p. 327 of *Delta*. The former, at p. 1272,

quotes with approval from *People ex rel. Finnegan* v. *McBride*, 226 N. Y. 252, 259, 123 N. E. 374, 376. See also the opinion in *Lubliner* v. *Board of Alcoholic Bev. Cont.*, 33 N. J. 428, 435, 165 Atl. 2d 163, 167 (1960), and Griswold, *Res Judicata in Federal Tax Cases*, 46 Yale L. J. 1320, 1326.

Soundly considered cases by this Court hold that the principles of *Res Judicata* apply in administrative law. *Tait* v. *Western Maryland R. Co.*, 289 U. S. 620, 623-4; *Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U. S. 381, 403; *Louisville & N. R. Co.* v. *Ohio Valley Tie Co.*, 242 U. S. 288; *Commissioner* v. *Sunnen*, 333 U. S. 591, 597-601; *United States* v. *Int. Bldg. Co.*, 345 U. S. 502, 504-5. See also 2 Davis, *Administrative Law Treatise*, Chapt. 18, pp. 545, et seq.

Res Judicata is often difficult to apply. In *Estevez* v. *Nabers*, 219 F. 2d 321, 323 (C. A., 5th), the test was laid down as to whether the two proceedings are merely the same and not the question of whether the first was "on the merits". In *Angel* v. *Bullinton*, 330 U. S. 183, 190-1, it was held that it was a misconception to assume that the doctrine does not come into operation after the first court had not passed on the "merits in the sense of the ultimate substantive issues of a litigation". Adjudication declining to reach these ultimate issues bars a second attempt to reach them again.

The situation at bar is one example of a situation where the administrative process reaches a palpably bad result with terrific consequences to the citizen involved. Organ had worked all his life in the securities business. He has no other occupation. After having been a salesman all these years, he decided to form his

own firm. On the questionable testimony of a hard-of-hearing, disgruntled customer (R. 37a) of a former employer (Lederer), not only has petitioner's firm, Organ & Co., been put out of business, but Organ himself, because he is called a "cause" of the revocation, is unable to be employed in any capacity by any broker-dealer licensed by the SEC. Vis-à-vis him and his government, such a result should not be condoned.

Under the principle sustained by the Court below, a broker-dealer revocation proceeding could be commenced years after his registration had become effective on grounds known from the beginning and investigated by the SEC. If this can be so, a lawyer could be disbarred for matters that had been thoroughly aired by the Character Committee before his admission. No citizen should be subject to such peril. We say that the Constitution and Congress never intended these consequences.

II.

The question of whether the SEC is acting fairly by participating in pre-hearing releases is squarely raised in this case.

The point was raised in *Gilligan, Will & Co.* v. *S. E. C.*, 267 F. 2d 461, 468 (2d Cir., 1959), cert. den. 361 U. S. 896. The Court of Appeals affirmed because petitioners had failed to assert the defect of pre-judgment before the SEC. It was held to be a waiver under Section 25(a) of the Securities Exchange Act of 1934. In the case at bar (R. 30a-31a), there was no waiver.

The Court below cogently remarked: "But we do not think the notice was a very good kind of notice for a government body to issue" (App. p. A-7).

Administrative agencies have a propensity to try their cases in newspapers. They publicize complaints, but do not give equivalent publicity to ultimate dismissals by the administrative bodies themselves or by the courts. Some years ago a prime offender was the Federal Trade Commission. Its practice was the subject of editorials and correspondence in the New York Times.

The difficulty is that once the financial community, close-knit and sensitive as it is, is directly advised through administrative release that its Staff has advised the SEC of a possible violation, tentative though it may be, the damage is done. This is particularly true of a broker-dealer application for registration. The business is doomed before it is launched, even though ultimately the complaint is dismissed.

The use of publicity by the SEC to effectuate its policies is well know. While, under Section 21(a) of the Securities Exchange Act, the SEC has discretionary power to publicize violations, it should only be used to effectuate the ends for which it was authorized.

Bank of America Nat'l Trust & Sav. Ass'n v. *Douglas*, 105 F. 2d 100, 105 (C.A., Dist. Col.), in dealing with this problem, noted that "such a power might easily be made an instrument of oppression." It was suggested that "pre-trial publication of evidence—labeled as believed to be true—ought, we think, to be avoided, especially as emanating from the tribunal

charged with the judicial responsibility of weighing it and assuring the accused a fair hearing".

Section 5 of the Administrative Procedure Act was expressly designed to maintain separation of prosecutor and judge in administrative proceedings. Section 5(*c*) expressly prohibits any officer, agent or employee engaged in investigative or prosecuting functions to participate or advise in the decision. *Won Yang Sung* v. *McGrath*, 339 U. S. 33; *Columbia Research Corp.* v. *Schaffer*, 256 F. 2d 677, 680 (2d Cir. 1958).

While agency heads are exempt, by the very nature of administrative agencies, they should follow the underlying policy.

We submit the decision below conflicts with the rationale in *United States ex rel. Accardi* v. *Shaughnessy*, 347 U. S. 260, 266-8, where it was held that a new trial was required if petitioner could prove that the Board of Immigration Appeals was influenced by a published list of undesirable aliens.

The opportunity to have an impartial and objective hearing is of the essence of the administrative as well as the judicial process. *N.L.R.B.* v. *Phelps*, 136 F. 2d 562, 563 (5th Cir.). No statute or regulation is required to give this right, since it is inherent in due process. The whole basis of the Administrative Procedure Act, with its detailed attempts to formulate fair procedure in administrative hearings, is seriously undermined when agency heads act in such a way that the slightest suspicion of irregularity taints the proceedings. It is unrealistic to think that the Commissioners can completely divorce themselves from the investigative function as to remain open-minded when

they review the record, especially when they are not bound by the Examiner's findings.

This case gives this Court an opportunity to establish the principle that the Commissioners word prehearing releases so as to avoid what appears to be public pronouncement of judgment before the actual trial of the matter. In that way, unfavorable implications and irreparable damage can be avoided.

Conclusion

The decision below raises important questions of administrative procedure which bear directly upon the powers of the agencies generally, and more particularly of the Securities and Exchange Commission, and on the constitutional rights of those dealing with agencies.

We believe the decision is in error and conflicts with the views expressed by this Court and by other courts of appeals.

The petition for certiorari should be granted.

Respectfully submitted,

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Appendix A

293 F. 2d 78

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 407—October Term, 1960.

(Argued June 7, 1961 Decided July 24, 1961.)

Docket No. 26876

N. SIMS ORGAN & CO., INC. and N. SIMS ORGAN,
Petitioners,

—v.—

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

Before:

LUMBARD, *Chief Judge*, and
GOODRICH* and FRIENDLY, *Circuit Judges.*

Petition to review an order of the Securities and Exchange Commission, 15 U. S. C. A. §78y(a), revoking broker-dealer registration and listing individual appellant as a cause.

Affirmed.

DAVID FERBER, Assistant General Counsel Securities and Exchange Commission Washington, D. C. (Walter P. North, General Counsel, and John A. Dudley, Attorney Securities and Exchange Commission, Washington, D. C., on the brief), *for appellee.*

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* Of the Third Circuit, sitting by designation.

DAVID UNTERBERG, New York, N.Y. (Unterberg and Unterberg, New York, N.Y., on the brief), *for appellant*.

GOODRICH, *Circuit Judge*:

This is a petition to review an order of the Securities and Exchange Commission which revoked Organ & Co.'s registration with the Commission as a broker and dealer in securities and recites that Organ is the cause of the revocation. The review is sought under Section 25(a) of the Securities Exchange Act of 1934, 15 U. S. C. A. §78y(a).

The background of the case may be summarized as follows:

J. H. Lederer Co., Inc. had been registered with the Commission as a broker and dealer. Its registration was revoked on December 28, 1958, for violation of fraud provisions of the statute. Organ was a salesman employed by Lederer in 1958, a period during which Lederer was conducting a selling campaign of stock of a company named Continental Mining Exploration, Ltd. Organ & Co. was organized in January, 1959, and its application for registration as a broker and dealer was received by the Commission on October 19, 1959. The Commission instituted proceedings to determine whether Organ, while employed by Lederer, had violated fraud provisions of the federal securities acts. The Commission postponed the effective date of Organ & Co.'s application for 15 days and directed a hearing to determine whether the effective date of registration should be further postponed pending denial proceedings. The hearing was held, but the Commission did not reach a determination on this question prior to the date on which the application

became effective by lapse of time.[1] The Commission, on January 28th, dismissed the denial proceeding on the ground that it had become moot and in the same order instituted a revocation proceeding which resulted in the revocation order under review here. The record developed in the preliminary hearing on postponement was incorporated into the record of the revocation proceeding. Petitioners make four points.

The first point is that the Commission's order is not supported by substantial evidence. Chiefly concerned in the consideration of this objection is the Commission's claim that certain representations made over the telephone and which were fraudulent[2] were made

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[1] Section 15(b) of the Securities Exchange Act of 1934 provides, in part:

"(b) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration. * * * Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine." 15 U. S. C. A. §78o (b).

[2] Section 17(a) of the Securities Act of 1933 provides:

"(a) It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U. S. C. A. §77q (a).

Section 10 of the Securities Exchange Act of 1934 provides, in part:

"It shall be unlawful for any person, directly or indirectly,

by Organ. There were two of these telephone conversations going to the same prospective customer. The caller identified himself as Organ. The recipient, who subsequently bought stock,[3] did not know Organ but identified the caller's voice as the same on the two occasions. Although this evidence might not be enough by itself to justify a conclusion that Organ was the caller, there was considerably more. The written confirmations of the sale received by the purchaser bore the initials "N. O." which were Organ's initials and Hallen, the purchaser, cancelled one of his purchases by notice addressed to Lederer marked to the attention of Organ. Further, Hallen was given a telephone number to call in order to get in touch with the salesman who identified himself as Organ, and this telephone number was used by Organ in calling other customers. The trial examiner did not think that this was enough to identify Organ as the caller on the telephone; the Commission thought otherwise. It is the Commission's responsibility to

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by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

"• • •

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U. S. C. A. §78j.

[3] The purchaser cancelled the first sale and testified that he personally followed the market activity of the stock not relying on the salesman's statements. The Commission is quite correct in its conclusion that reliance is not an element of the violation charged. 15 U. S. C. A. §§77q (a), 78j. See *Hughes* v. *SEC*, 174 F. 2d 969, 973-4 (D. C. Cir. 1949).

decide the question and the fact that it differed with the examiner does not matter.[4]

The Commission pointed out correctly that this is a non-criminal case and that Organ's failure to testify is significant. He did not deny the evidence just recited and the accepted rule is that failure to explain facts and circumstances warrants the inference that his testimony would have been adverse.[5]

We agree with the Commission that the factors are sufficient to establish Organ as the maker of the communication.[6]

The second point is that the proceedings fell under the principles set out in *Jencks* v. *United States*, 353 U. S. 657 (1957).

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[4] Section 15 of the Securities Exchange Act of 1934 provides, in part:

> "The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, * * * has willfully violated any provision of the Securities Act of 1933, or of this chapter, or of any rule or regulation thereunder." 15 U. S. C. A. §780.

See *Pierce* v. *SEC*, 239 F. 2d 160, 162-3 (9th Cir. 1956). *Cf.*, *FCC* v. *Allentown Broadcasting Corp.*, 349 U.S. 358, 364 (1955). The only significant difference between the examiner's Recommended Decision and the Findings and Opinion of the Commission is the ultimate conclusion to be attached to all of the evidence presented. The Commission is fully as capable of drawing that conclusion as is the examiner.

[5] Wigmore, Evidence §289 (3d ed. 1940); McCormick, Evidence §249 (1954). But see, *U. S.* v. *Costello*, 275 F. 2d 355 (2d Cir. 1960), *aff'd*, 365 U.S. 265 (1961).

[6] While rigid evidentiary rules are not to be applied to administrative agencies, *FTC* v. *Cement Institute*, 333 U.S. 683, 705-6 (1948), the evidence of surrounding circumstances in this case was sufficient to conclude that Organ was the caller even under the more stringent rules applicable in criminal proceedings. See *Jarvis* v. *United States*, 90 F. 2d 243 (1st Cir.), *cert. denied*, 302 U.S. 705 (1937).

An investigator for the Commission interviewed Hallen and made notes for the purpose of preparing an affidavit to be signed by Hallen. He did prepare such an affidavit and destroyed the notes. Hallen did not see the notes which, it was testified, were simply to serve as cues for the preparation of the affidavits by the investigator. In the hearing Hallen was shown the affidavit to refresh his recollection. Petitioners' counsel had opportunity before Hallen testified to read the affidavit, and it was in the hands of petitioners' counsel for cross-examination of Hallen.

There was no suggestion that these notes were destroyed with any intent to suppress evidence. See *United States* v. *Thomas*, 282 F. 2d 191 (2d Cir. 1960). There was no refusal by the Government to produce a statement within the meaning of the so-called "Jencks" statute. 18 U. S. C. §3500. The only statement that Hallen signed was shown to Organ's counsel as stated above. There was no violation of any right of Organ involved here.

Third, petitioners charge that the Commission's publication of the notice of the proceedings constituted a prejudgment against them and was a denial of due process. This Court had occasion to comment on this subject in *Gilligan, Will & Co.* v. *SEC*, 267 F. 2d 461 (2d Cir.), *cert. denied* 361 U. S. 896 (1959). It was there said:

> "Apart from §5 [of the Administrative Procedure Act] and the restrictions it may impose, the Commission's reputation for objectivity and impartiality is opened to challenge by the adoption of a procedure from which a distinterested observer may conclude that it has in some measure adjudged the facts as well as the law of a par-

> ticular case in advance of hearing it. There would appear to be no such conflict between the Commission's duty to inform the public and its duty to prosecute as would necessitate the use of press releases of the kind here questioned." 267 F. 2d at 468-9.

We reiterate that statement. It is not the business of this or any other court to write publicity notices for the Commission. But we think it should be borne in mind that when the body which is the investigator, the prosecutor and the judge starts a proceeding by saying that the order of the Commission asserts that members of its staff have reported information tending to show that Organ has violated anti-fraudulent provisions, it creates an impression which could be interpreted as tending to indicate that the Commission had already made up its mind. We do not think the Commission intended such a result; we certainly do not indicate that due process of law was denied to the petitioners. But we do not think the notice was a very good kind of notice for a government body to issue.

Fourth, petitioners claim that *res judicata* operates to prevent the order under attack from being valid. They base this, of course, on the dismissal of the denial proceedings, but those proceedings did not decide anything. They were dismissed as moot because action of the Commission was not taken until the application for registration had become effective by lapse of time under the provisions of the statute.[7] It is well settled that the dismissal of a case because it

[7] See note 1 *supra*.

is moot does not lay a basis for the application of the doctrine of *res judicata*.[8]

The petitioners in a letter submitted after argument urge that *CAB* v. *Delta Air Lines, Inc.*, 367 U. S. 316, decided June 12, 1961, is controlling here. We think not. In that case the Aeronautics Board allowed a certificate of convenience and necessity to become effective by lapse of time despite pending petitions for reconsideration of the award. Subsequently the Board imposed restrictions on the certificate without formal notice or hearing. The precise holding of the Supreme Court was that the statutory mandate of notice and hearing must be complied with before an existing certificate can be amended or modified. There was no discussion of or reliance upon the fact that the evidence on which the restrictions were based was before the Board when the certificate became effective by lapse of time. In the instant case after the certificate became effective by lapse of time the Commission instituted a revocation proceeding, as authorized by statute,[9] and conducted a hearing. The record developed in the earlier proceeding was incorporated into the record of the revocation proceeding. Petitioners had full opportunity to rebut any damaging evidence before the Commission at the revocation hearing. That they failed successfully to do so does not in any way reflect any improper action by the Commission.

The decision of the Commission will be affirmed.

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[8] *Cf.* Restatement, Judgments §69(2) and Comment *e*. It has also been held that the doctrine of estoppel is not available against the SEC. *SEC* v. *Culpepper*, 270 F. 2d 241 (2d Cir. 1959); *SEC* v. *Morgan, Lewis & Bockius*, 209 F. 2d 44 (3d Cir. 1953).

[9] See note 4 *supra*.

Appendix B

FINDINGS AND OPINION OF THE COMMISSION

(Securities Exchange Act Release No. 6495)

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

March 14, 1961

In the Matter of

N. Sims Organ & Co., Inc.
460 East Park Street
Long Beach, L. I., New York

File No. 8-7919

Securities Exchange Act of 1934—
Sections 15(b) and 15A(b)(4)

Broker-Dealer Registration

Grounds for Revocation of Registration

Fraud in Offer and Sale of Securities

Where president and principal stockholder of registered broker-dealer, while salesman for another broker-dealer, made false and misleading statements in offer and sale of securities concerning, among other things, future market price, prospective earnings, and length of time his employer had been in business, *held* under all the circumstances public interest requires revocation of registration.

Estoppel

Where, in previous revocation proceeding against registered broker-dealer firm, Commission did not place a salesman's activities in issue, *held*, Commission not estopped from doing so in subsequent revocation proceeding against another registered broker-dealer firm of which he is president and principal stockholder.

Res Judicata

Double Jeopardy

Where Commission, after hearing on question whether effective date of application for broker-dealer registration should be postponed pending final determination whether such registration should be denied, permitted registration to become effective by lapse of time and dismissed denial proceeding as moot, and thereafter instituted revocation proceeding based on same allegations as in denial proceeding, *held*, issues in prior proceeding were not determined on the merits and doctrine of *res judicata* is not applicable to revocation proceeding; *further held*, double jeopardy not involved in institution of revocation proceeding.

APPEARANCES:

John J. Devaney, Jr. and *Bernard M. Krakower*, of the New York Regional Office of the Commission, for the Division of Trading and Exchanges.

David Unterberg and *Abbie Goldstein*, of Unterberg and Unterberg, for N. Sims Organ & Co., Inc. and N. Sims Organ.

By Woodside, Commissioner:

These are proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the registration as a broker and dealer of N. Sims Organ & Co., Inc. ("registrant") should be revoked, and whether, under Section 15A(b)(4) of the Exchange Act, N. Sims Organ, president, treasurer, a director and owner of 10% or more of the stock of registrant, should be found to be a cause of an order of revocation if entered.[1]

The order for proceedings alleges that between February and November 1958, Organ, while employed as a salesman by J. H. Lederer Co., Inc. ("Lederer Co."), then a registered broker and dealer,[2] made certain false and misleading statements in the offer and sale of stock of Continental Mining Exploration Ltd. ("Continental") in willful violation of anti-fraud provisions of the Securities Act of 1933 ("Securities Act") and the Exchange Act.[3]

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[1] Section 15(b) of the Exchange Act, as here applicable, provides that we shall revoke the registration of a broker or dealer if we find that it is in the public interest and that such broker or dealer or any officer, director, or controlling person of such broker or dealer, whether prior or subsequent to becoming such, has willfully violated any provision of that Act or of the Securities Act of 1933 or any rule or regulation thereunder.

Under Section 15A(b)(4) of the Exchange Act, in the absence of our approval or direction, no broker or dealer may be admitted to or continued in membership in a registered securities association if the broker or dealer or any partner, officer, director or controlling or controlled person of such broker or dealer was a cause of an order of revocation which is in effect.

[2] We revoked the broker-dealer registration of Lederer Co. on December 28, 1958. 38 S.E.C. 794.

[3] The anti-fraud provisions referred to are Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 (17 CFR 240.10b-5) thereunder. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or

After appropriate notice, a hearing was held before a hearing examiner. Thereafter, our Division of Trading and Exchanges ("Division") filed proposed findings and a supporting brief, and registrant filed a brief. The hearing examiner submitted a recommended decision in which he found that fraudulent representations had been made by a salesman for Lederer & Co., but that the evidence did not establish that the salesman was Organ, and he recommended that the proceedings be dismissed. Exceptions were filed by the Division and by registrant. Our findings are based upon an independent review of the record.

Registrant, a New York corporation organized in January 1959, became registered as a broker and dealer in December 1959.

The evidence shows that a Mr. H received two long-distance telephone calls, in March and April 1958, from a salesman of Lederer Co. who identified himself as Organ and solicited the purchase of Continental stock. This salesman represented that the stock, which was selling for about $3.50 per share in March 1958, was a "fabulous" stock, was going to be a "tremendous money-maker," was a "tremendous buy," was going up "steadily," should go up to $4 within a few days, and would reach $6 "shortly" or within 60 days, and that Lederer Co. had been in business 27 or 28 years. Mr. H purchased 300 shares at $3.45 per share in March, and 1,000 shares at $3.65 per share in April 1958, and he received confirmations of the sales through the mails which did not contain Organ's name, but bore a number followed by the letters "NO."

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sale of any security by means of a device to defraud, an untrue or misleading statement of a material fact, or any act, practice or course of business which operates or would operate as a fraud or deceit upon a customer, or by means of any other manipulative or fraudulent device.

which are the initials of Organ's first and last names. Mr. H cancelled his March purchase by letter which he testified he believed he addressed to Organ's attention.

During one of the telephone calls, the salesman gave Mr. H a telephone number in case he wished to call, which number was different from the telephone number printed on the confirmations, and the record shows that a salesman named Organ, no first initial being given, used the telephone number given to Mr. H in making long distance calls to other customers in behalf of Lederer Co.

On the basis of the foregoing, the hearing examiner found that the representations made to Mr. H were materially false and misleading, but that, as urged by registrant, the identity of the salesman as N. Sims Organ had not been established by the evidence.

We agree with the examiner that the representations were fraudulent. Continental had suffered net losses of $82,664 in 1956 and $584,102 in 1957. This financial information was available to the salesman but he apparently made no effort to obtain it. In view of Continental's unfavorable financial condition, which was not disclosed to Mr. H, we find that the optimistic statements concerning the prospects of the stock had no reasonable basis in fact, and accordingly were materially false and misleading.[4] Registrant asserts that the statements regarding the future increase in market price were merely "puffing." However, even assuming that "puffing" may be permissible in connection with the sale of merchandise other than

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[4] *R. R. Michaels & Co.*, Securities Exchange Act Release No. 6461 (February 6, 1961); *Barnett & Co., Inc.*, Securities Exchange Act Release No. 6310, p. 4 (July 5, 1960); *Leonard Burton Corporation*, Securities Exchange Act Release No. 5978, p. 4 (June 4, 1959).

securities, it is clear that statements in the offer and sale of securities which are materially false or misleading are proscribed by the securities laws. Registrant also contends that since Mr. H cancelled the first sale and thereafter personally followed the market activity of Continental stock, his second purchase was not induced by the Lederer Co. salesman. However, under Section 17(a) of the Securities Act, false and misleading statements are unlawful in the offer as well as the sale of securities,[5] and in any event, reliance on such statements need not be shown to establish a violation under that section or Section 10(b) of the Exchange Act.[6] Moreover, the statement that Lederer Co. had been in business for 27 or 28 years, when in fact it had been registered as a broker or dealer less than three years, was materially false.[7]

We reject, however, the examiner's finding that the evidence failed to establish that the salesman who made the fraudulent representations was N. Sims Organ. Registrant did not deny that Organ was the salesman involved, but argued that the testimony concerning that salesman's statements over the telephone was hearsay and should have been excluded. However, as we said in *A. G. Bellin Securities Corp.*,[8] "Administrative agencies are not bound by the technical com-

[5] See *First Maine Corporation*, 38 S.E.C. 882, 889 (1959); *Brereton, Rice & Co., Inc.*, 37 S.E.C. 618, 621 (1957).

[6] See *Hughes* v. *S.E.C.*, 174 F. 2d 869, 973-74 (C.A.D.C. 1949); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 831 (D. Del. 1951).

[7] We note in this connection that Joseph H. Lederer, who was Lederer Co.'s president and principal stockholder, had been in various types of securities activities since 1918. However, the salesman was referring to Lederer Co., not Lederer, and in any event the statement was at least materially misleading.

[8] Securities Exchange Act Release No. 5966, p. 11 (May 18, 1959).

mon law rules concerning the admission of hearsay evidence, and may make findings based on hearsay if corroborated by competent evidence." Moreover, telephone conversations have been admitted in judicial proceedings where there was some evidence, either direct or circumstantial, of the identity of the person whose statements were in issue.[9] The test of sufficiency of circumstantial evidence is whether there are "facts in evidence which if unanswered would justify men or ordinary reason and fairness" in finding in favor of the proponent of the evidence.[10] The proof of identity, as of any other fact in proceedings of this nature, need only be by a preponderance of evidence or probability, that is, the evidence should be sufficient to persuade us that it is more probable that Organ was the salesman in question than that he was not.[11] Thus, in *Andrews* v. *U. S.*,[12] the evidence of the identity of the defendant as the person who had long-distance conversations with investors, during which allegedly fraudulent statements were made, consisted of the record of the telephone company which showed that long-distance calls were placed and conversations had from defendant's office with the investors at about the times fixed in their testimony, and of receipts for

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[9] See *Andrews* v. *U. S.*, 78 F. 2d 274, 275 (C.A. 10, 1935); *Jarvis* v. *U. S.*, 90 F. 2d 243, 245 (C.A. 1, 1937), cert. denied 302 U.S. 705; *Van Riper* v. *U. S.*, 13 F. 2d 961, 968 (C.A. 2, 1926), cert denied *sub nom. Ackerson* v. *U. S.*, 273 U.S. 702.

[10] 9 *Wigmore, Evidence* (3d Ed., 1949), Sec. 2494.

[11] *Wright* v. *S.E.C.*, 112 F. 2d 89, 94 (C.A. 2, 1940); *Archer* v. *S.E.C.*, 133 F. 2d 795, 799 (C.A. 8, 1943), cert. denied 319 U.S. 767. In calculating the probabilities as applied to a question of identification, the odds against the appearance of each of the several circumstances bearing on the question of identity are multiplied, not merely added. *McCormick, Evidence* (1954), Sec. 171, 319.

[12] 78 F. 2d at 275.

money and correspondence subsequently passing between them. The Court, holding that in order to render testimony detailing a telephone conversation competent it is necessary to supply some evidence of the identity of the person with whom the conversation is alleged to have been had, concluded that the evidence produced supplied the required foundation for the introduction of the challenged testimony. The Court stated that "recognition of the voice is not necessary to such identity. Like any other ordinary fact, it may be established by direct evidence or by circumstances."

The hearing examiner, in concluding that the evidence was not sufficient to establish that Organ was the salesman who made the fraudulent representations, failed to take into account registrant's failure to deny that the salesman in question was Organ. We consider such failure to be a factor of substantial significance,[13] particularly in the present context in which Organ desires to retain a license to engage in business involving dealings with customers in the face of charges that he acted improperly with respect to Mr. H. In our opinion, such failure, together with the other circumstances bearing on the question of identity-including the fact that Organ was a salesman in the office of Lederer Co. during the period involved, that the salesman twice identified himself over the telephone as Organ, the let-

[13] The failure of a party to testify, in a non-criminal case, in explanation of suspicious facts and circumstances peculiarly within his knowledge fairly warrants the inference that his testimony, if produced, would have been adverse. See *Local 167* v. *U. S.*, 291 U.S. 293, 298 (1934); *Mammoth Oil Company* v. *U. S.*, 275 U.S. 13, 52-3 (1927); *Kirby* v. *Tallmadge*, 160 U.S. 379, 383 (1895); *Daniel* v. *U. S.*, 234 F. 2d 102, 106 (C.A. 5, 1956); *Meier* v. *Commissioner*, 199 F. 2d 392, 396 (C.A. 8, 1952); 2 *Wigmore, Evidence* (1940), Sec. 289. In an action for rescission and damages brought by Mr. H against Lederer Co., Lederer, Organ and another salesman, no denial was made to allegations by Mr. H that sales to him were made by Organ.

ters "NO" appeared on the confirmations, the notice of cancellation addressed to Organ to the best of Mr. H's recollection was followed by cancellation of his transaction, and the same telephone number as was given to Mr. H by the salesman who identified himself as Organ was used by a Lederer Co. salesman named Organ in calling other customers-convinces us that N. Sims Organ was the salesman who made the fraudulent representations to Mr. H. We accordingly conclude that Organ willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Other Matters

Registrant contends that since, in the revocation proceedings against Lederer Co., we did not place Organ's activities in issue even though we assertedly were aware of them at that time, we are estopped in the instant proceedings from finding any violations by him while employed by Lederer Co. However, it has been held that the doctrine of estoppel cannot be invoked against us so as to prevent us from performing our statutory functions,[14] and we accordingly reject registrant's contention.

Registrant further contends that these proceedings should be dismissed on the ground that, on the basis of applicable principles of *res judicata,* the issues herein had already been decided on the merits in its favor in denial proceedings instituted by us pursuant to Section 15(b) of the Exchange Act in connection with registrant's application for registration, by virtue of our permitting such application to become effective

[14] See *S.E.C.* v. *Culpepper*, 270 F. 2d 241, 248 (C.A. 2, 1959); *S.E.C.* v. *Morgan, Lewis & Bockius*, 209 F. 2d 44, 49 (C.A. 3, 1953).

after a hearing on the same issues and our dismissal of the denial proceedings as moot.

The earlier proceedings, which were based on the same allegations as those in the instant proceedings, were instituted prior to the effective date of the application for registration in order to determine not only whether registration should be denied but also whether the effective date of such registration should be postponed until final determination upon the question of denial. We ordered that a hearing be held before a hearing examiner on the question whether, pursuant to Section 15(b) of the Exchange Act, it was necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of registration until final determination on the question of denial.[15] We directed that the hearing examiner transmit the record to us, and stated that, after the parties had an opportunity to file proposed findings and briefs, we would issue our findings and opinion on the question of postponement. We further ordered that, if the effective date were postponed, a further hearing be held before the examiner on the question of denial of registration to applicant. A preliminary hearing was held before the examiner for the limited purpose of determining the question of postponement of the effective date of registration, but that question not having been determined by us prior to the effective date, the registration became effective by lapse of time. We accordingly dismissed the denial proceedings as moot, and instituted the instant revocation proceedings.

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[15] Under Section 15(b) of the Exchange Act, registration becomes effective 30 days after filing of the application, except that we may by order postpone the effective day for a period not exceeding 15 days, and, after notice and opportunity for hearing, pending final determination whether registration shall be denied.

It is clear that the merits of the allegations of willful violations were not involved in the preliminary proceedings, but only the question whether it was "necessary or appropriate in the public interest or for the protection of investors to postpone the effective date" of registration. By failing to issue an order of postponement, we permitted registration to become effective, but we did not thereby definitively find that willful violations were or were not committed as charged. Nor have we made such definitive findings in cases were we have postponed registration.[16] The willful violations we have found herein were not in issue in the postponement proceeding, and accordingly the principles of *res judicata* are inapplicable to the instant proceedings.[17]

Registrant also argues that these proceedings violate the double jeopardy and due process provisions of the Constitution. However, as indicated above, no consideration of the merits of the issues as to the alleged violations was reached until the instant revocation proceedings and, in any event, the prohibition against double jeopardy relates to criminal prosecutions and does not apply to remedial proceedings under

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[16] See *Irving Grubman*, Securities Exchange Act Release No. 6385 (October 6, 1960); *M. Paul Conant and Co., Inc.*, Securities Exchange Act Release No. 6118 (November 12, 1959). In cases where we have suspended registration in the public interest pending final determination of revocation proceedings under Section 15(b), we also do not make findings of willful violations. *A. G. Bellin Securities Corp.*, Securities Exchange Act Release No. 5966 (May 18, 1959); *Peerless-New York, Incorporated*, Securities Exchange Act Release No. 6193 (February 26, 1960); *Biltmore Securities Corp.*, Securities Exchange Act Release No. 6394 (October 11, 1960).

[17] See *Kelaghan* v. *Industrial Trust Co.*, 211 F. 2d 134 (C.A. 1, 1954); *Allegheny County* v. *Maryland Casualty Co.*, 146 F. 2d 633 (C.A. 3, 1944), cert. denied 325 U.S. 855; *U.S.* v. *Erie Forge Co.*, 191 F. 2d 627, 629 (C.A. 3, 1951), cert. denied 343 U.S. 930; *Restatement, Judgments*, Sec. 69(2) (1942).

Section 15(b) of the Exchange Act.[18] Registrant did not specify the basis for its contention that it was denied due process, but our examination of the record does not disclose any support for such contention.

Public Interest

In view of the willful violations we have found, we conclude that it is in the public interest to revoke registrant's registration, and we further conclude that Organ is a cause of such revocation.

Rulings on Exceptions

We have considered the recommended decision of the hearing examiner and the exceptions thereto, and to the extent such exceptions involve issues which are relevant and material to the decision in this case, we have by our Findings and Opinion herein already ruled upon them. We hereby expressly sustain such exceptions to the extent that they are in accord with the views set forth herein, and we expressly overrule them to the extent that they are inconsistent with such views.

An appropriate order will issue.

Chairman Gadsby and Commissioners Hastings and McCauley join in the above opinion.

Attest:

ORVAL L. DUBOIS
Orval L. DuBois
Secretary

(Seal)

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[18] See *Helvering* v. *Mitchell*, 303 U.S. 391, 398-99 (1938); *Pierce* v. *S.E.C.*, 239 F. 2d 160, 163 (C.A. 9, 1956); *Wright* v. *S.E.C.*, 112 F. 2d 89, 94 (C.A. 2, 1940).

ORDER REVOKING BROKER-DEALER REGISTRATION

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

March 14, 1961

In the Matter of

N. SIMS ORGAN & CO., INC.
460 East Park Street
Long Beach, L. I., New York

File No. 8-7919

Securities Exchange Act of 1934—
Sections 15(b) and 15A(b)(4)

Proceedings having been instituted pursuant to Sections 15(b) and 15A(b)(4) of the Securities Exchange Act of 1934 to determine whether to revoke the registration of N. Sims Organ & Co., Inc., and whether N. Sims Organ is a cause of an order of revocation if entered;

A hearing having been held after appropriate notice, proposed findings and briefs having been filed, the

hearing examiner having filed a recommended decision, and exceptions thereto having been filed;

The Commission having this day issued its Findings and Opinion; on the basis of said Findings and Opinion

IT IS ORDERED that the registration of N. Sims Organ & Co., Inc., as a broker and dealer be, and it hereby is, revoked, and it is found that N. Sims Organ is a cause of such revocation.

By the Commission.

ORVAL L. DUBOIS
Orval L. DuBois
Secretary

(Seal)

Appendix C

DECREE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 26876

N. SIMS ORGAN & CO., INC., and N. SIMS ORGAN,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

THIS CAUSE came on to be heard upon the petition of N. Sims Organ & Co., Inc., and N. Sims Organ for a review of the order of the Securities and Exchange Commission, dated March 14, 1961, in a proceeding before said Commission in File no. 8-7919, revoking the broker-dealer registration of N. Sims Organ & Co., Inc., and finding that N. Sims Organ is a cause of such registration; upon the transcript of the record in such proceeding, certified and filed in this Court; and the matter having been argued and due deliberation having been had.

ON CONSIDERATION WHEREOF, it is ordered, adjudged and decreed by the United States Court of Appeals for the Second Circuit, that the said order of the Securities and Exchange Commission be, and the same is hereby affirmed.

J. EDWARD LUMBARD
Judge, United States Court of Appeals
for the Second Circuit

HENRY J. FRIENDLY
Judge, United States Court of Appeals
for the Second Circuit

FILED: September 19, 1961.

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628890—62——1

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 585

N. SIMS ORGAN & CO., INC. AND N. SIMS ORGAN,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. A1–A8) is reported at 293 F. 2d 78. The findings and opinion of the Securities and Exchange Commission (Pet. App. B1–B12) are set forth in Securities Exchange Act Release No. 6495.

JURISDICTION

The judgment of the Court of Appeals affirming the order of the Securities and Exchange Commission was entered on September 19, 1961 (Pet. App. C1–C2).

The petition for a writ of certiorari was filed on December 4, 1961. The jurisdiction of this Court is invoked under Section 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78y, and 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether, after a registration as a broker and dealer in securities had become effective by lapse of time before the merits of charges of fraudulent conduct were determined in a proceeding looking towards denial of registration, the Securities and Exchange Commission was precluded from considering the same charges in a proceeding to revoke the registration.

2. Whether publication in the Commission's daily news digest of notice that a proceeding has been instituted against an applicant for registration upon the basis of charges brought by the Commission's staff constitutes a prejudgment of the issues and a denial of due process.

STATUTE INVOLVED

The pertinent provisions of Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 780, 48 Stat. 895–896, as amended, 49 Stat. 1377–1378, are set forth in the Appendix, *infra*, pp. 13 to 16. The section is misquoted in the petition.

STATEMENT

The individual petitioner, N. Sims Organ, was a salesman employed by J. H. Lederer Co., Inc., a registered securities broker and dealer, during a period in 1958 in which that firm conducted a fraudulent

stock-selling campaign (Pet. App. B-8). These activities resulted in revocation of that company's registration on December 28, 1958 (Pet. App. B-3). See *J. H. Lederer Co.*, 38 S.E.C. 794. Within a month after the revocation, petitioner N. Sims Organ & Co. (referred to herein as Organ & Co.) was organized, and application was made thereafter for its registration as a broker and dealer (Pet. App. B-4). N. Sims Organ is the president, treasurer, a director and owner of ten percent or more of the stock of Organ & Co. (Pet. App. B-3).

Prior to the effective date of Organ & Co.'s registration the Commission instituted a proceeding under Section 15(b) of the Act to determine whether Mr. Organ, a controlling person of Organ & Co., had violated anti-fraud provisions of the federal securities acts when he had been employed by Lederer Co., and, if so, whether it was in the public interest to deny the application, and whether Mr. Organ was to be found the cause of any order of denial.[1] The order initiating the proceeding recited that members of the Commission's staff had reported information obtained as a result of an investigation which tended to show the violations charged (R. 16a). In the same order, and again pursuant to Section 15(b), the Commission postponed the effective date of Organ & Co.'s registration for 15 days until December 21, 1959, and directed that a preliminary hearing before one of its

[1] Pursuant to Section 15A(b)(4) of the Act, as added, 52 Stat. 1070, such a finding renders it difficult for an individual to engage in the securities business.

hearing examiners be held to determine whether the effective date of registration should be further postponed pending the denial proceedings (R. 18a). The order also stated that, if the effective date were postponed, a further hearing would be held on the question of denial of registration (R. 13a).

The preliminary hearing was conducted December 2, 1959, and the examiner transmitted the hearing record to the Commission without filing a recommended decision. Thereafter, no further action was taken by the Commission, its staff or the examiner until January 28, 1960 (R. 18a). No determination was made whether the evidence adduced at the hearing warranted a further postponement of the date of registration while the merits of the charges of fraudulent activities were to be heard and decided.

As a result of the lapse of time, Organ & Co.'s registration became effective on December 21, 1959 (R. 20a). Thereafter, on January 28, 1960, the Commission ordered the denial proceeding dismissed on the ground that it had become moot and instituted a proceeding on the same charges to revoke the registration, which resulted in the order now under review (R. 19a–22a). At the ensuing hearing before the same examiner, the record developed in the preliminary hearing on postponement was included by consent as part of the record. Some additional evidence was received, although none of the evidence pertained to activities subsequent to the effective date of Organ & Co.'s registration (R. 23a; 54a–58a).

As appears from the Commission's detailed findings and opinion (Pet. App. B1–B12), the Commis-

sion found that Mr. Organ, in willful violation of anti-fraud provisions of the Securities Act and the Securities Exchange Act, had made misrepresentations over the long-distance telephone while employed by Lederer Co.[1] In view of these willful violations, the Commission concluded that it was in the public interest to revoke Organ & Co.'s registration. The Commission entered an order of revocation and found that Mr. Organ was a cause of such revocation (Pet. App. B13–14).

The Court of Appeals for the Second Circuit affirmed this order, agreeing with the Commission that the evidence established that Mr. Organ had made the misrepresentations charged (Pet. App. A5). The court also considered and rejected other contentions by petitioners which are repeated in the instant petition (Pet. App. A6–A8).

ARGUMENT

The decision of the court below was correct and does not conflict with the decisions of this Court or of other courts of appeals.

1. Petitioners apparently contend that the Commission is without authority under Section 15(b) of the Securities Exchange Act of 1934 to revoke the registration of a broker and dealer in securities where the evidence of violations upon which a revocation could otherwise be based may have been known to the Commission or its staff prior to the date the

[1] In this regard the Commission differed from the examiner who had found the evidence insufficient to tie the individual petitioner to the fraudulent activities.

application for registration became effective. Relying on the abortive proceeding to determine whether to postpone the registration, they argue that the doctrine of *res judicata* buttresses their contention.[3] The governing statute, however, as the court below held, does not compel the anomalous result sought, whereby a person who is found on a proper record to have willfully violated anti-fraud provisions of the federal securities laws must be permitted to remain in the securities business, contrary to the public interest, merely because proceedings might have been brought against him at a somewhat earlier date.

Section 15(b) of the Securities Exchange Act provides that "the Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest" and, *inter alia,* that the controlling person of the broker or dealer has willfully violated anti-fraud provisions of the statute or of the Securities Act of 1933. The grounds for denial and revocation are the same, and it is expressly provided that either sanction may be based on misconduct committed by the controlling person, "whether prior or subsequent to" his affiliation with the particular broker or dealer.

In the absence of institution of proceedings by the Commission, an application for registration under

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[3] Petitioners nowhere claim that they changed position to their detriment following the effective date of the registration and prior to the institution of revocation proceedings five weeks later.

Section 15(b) of the Act becomes automatically effective thirty days after filing. Where the Commission initiates a proceeding to determine whether to deny an application, Section 15(b) specifically empowers it, without a hearing, to postpone the effective date of registration for a period not exceeding fifteen days. In addition, the Commission is authorized to postpone the effective date for an indefinite period pending final determination of the denial proceeding where, after notice and opportunity for hearing, such postponement "shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors."[4]

There is nothing in the statute, its legislative history or in the petition which indicates that Congress intended that the Commission's failure to institute denial proceedings prior to the effective date of a registration application would grant the applicant immunity from a subsequent revocation based upon any information then known to the Commission or its staff. The statute is remedial in nature and is to be interpreted in accordance with its purpose, which is to protect the public from brokers, dealers,

[4] It is and has uniformly been the Commission's administrative practice to issue an order upon termination of any hearing proceeding. This, in fact, is a requirement of Section 8(b) of the Administrative Procedure Act (5 U.S.C. 1007(b)). No such order was issued here prior to the date registration was to become effective or thereafter until January 28, 1960, when revocation proceedings were instituted. Thus, Mr. Organ, who was not a newcomer to the securities business and who was represented by counsel in the proceedings, should have recognized that review of the charges had not been concluded.

and other persons who have engaged in activities violating the securities legislation. In effect, the abortive denial proceeding was rendered a nullity by the Commission's failure to act. Thus, it should be given no greater legal effect than is given the Commission's failure initially to set down for hearing an application as to which there was in its files some evidence of misconduct.

In petitioners' case, since the Commission had not determined whether the public interest warranted a further postponement, the registration became effective without review or decision of the merits of any of the charges. By initiating the revocation proceeding upon the identical charges shortly thereafter,[5] the Commission, in essence, continued the proceeding, so that the merits of the outstanding and undermined charges could be decided. Since Section 15(b) sets forth identical grounds for denial and revocation, it necessarily contemplates that revocation might be premised on violations prior to registration.

As pointed out by the Court of Appeals (Pet. App. A7–A8), since nothing was decided in either the preliminary hearing on postponement or the denial proceeding that had become moot, *res judicata* is clearly

[5] Registration became effective on December 21, 1959. The order dismissing the denial proceeding as moot and instituting the revocation proceeding was entered on January 28, 1960 (see, *supra*, at pp. 3–4).

inapplicable. Although petitioners concede that no determination was made by the Commission (Pet. 6), they nonetheless claim effects of *res judicata* for its inaction. However, the cases cited at page 12 of their petition are not in point. Each involved a situation where a determination, either explicit or implicit, had been made in some prior proceeding. Here the Commission failed to act at all. No explicit determination was made. No implicit determination can be spelled out from its lack of action in the denial proceeding prior to the time the registration became effective. Nor is the situation in this case in any way comparable to the hypothetical situation set forth at page 13 of the petition where "a lawyer could be disbarred for matters that had been thoroughly aired by the Character Committee before his admission." Presumably the character committee is required to make a determination prior to admission; the Commission is not required by the statute to make a determination prior to effectiveness of a registration.

The decision below is not in conflict with *Civil Aeronautics Board* v. *Delta Lines, Inc.*, 367 U.S. 316,* or *United States* v. *Seatrain Lines, Inc.*, 329 U.S.

* Petitioners inappropriately insert "[SEC]" in quoted material from the opinion of this Court in *Civil Aeronautics Board* v. *Delta Lines, Inc.*, appearing at page 10 of the petition. The Commission was not involved in that action in any respect.

494, as petitioners contend (Pet. 9). Revocation here occurred after petitioners had the full evidentiary hearing contemplated by the Securities Exchange Act, whereas in *Delta Lines, Inc.*, this Court rested its holding on the fact that the respondent had not been afforded the hearing required by the Federal Aviation Act. Moreover, the certificate of public convenience and necessity there involved had been granted by a decision of the Civil Aeronautics Board after a hearing and cannot be equated with an application for registration under Section 15(b) of the Securities Exchange Act which became effective automatically after filing without any action on the part of the Commission. In *United States* v. *Seatrain Lines, supra*, it was held that the statute, the Interstate Commerce Act, did not authorize revocation of the certificate held by respondent. Section 15(b) of the Securities Exchange Act, however, as we have seen, specifically authorizes revocation.

2. The Court of Appeals correctly rejected petitioners' charge that the notice of the administrative proceedings in the Commission's daily news digest constituted prejudgment of the issues or was otherwise violative of due process (Pet. App. A6–A7). While the court believed that the wording created "an impression which could be interpreted as tending to indicate that the Commission had already made up its mind" (Pet. App. A7), it pointed out that it did not believe such impression was intended.

The item in question was entitled "FRAUD CHARGED TO N. SIMS ORGAN CO." and recited:

> The SEC has issued an order under the Securities Exchange Act of 1934 postponing the effective date of registration of N. Sims Organ & Co., Inc., 460 E. Park St., *Long Beach, L.I., New York,* as a broker-dealer, and ordering a hearing on the question whether such registration should be denied. B. [*sic*] N. Sims Organ is president, treasurer, director, and owner of 10% or more of the common stock of N. Sims Organ & Co., Inc.

It then set forth that:

> The order of the Commission asserts that members of its staff have reported information obtained as a result of an investigation which tends to show that * * *

the anti-fraud provisions of the federal securities acts had been violated by Mr. Organ in the manner described therein.

Pursuant to statute it is the Commission's function to institute disciplinary proceedings based upon information reported to it by its staff. Section 22 of the Securities Exchange Act, 15 U.S.C. 78v, which provides that hearings under the Act "may be public," is authorization to the Commission to alert the investing public, where, as here, a salesman with whom they may be dealing has been charged with willful violations of the anti-fraud provisions of the federal securities acts. Such releases reporting the

results of staff investigations are customarily issued in the performance of this statutory duty and do not prejudice the Commission's subsequent consideration of the charges.'

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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DAVID FERBER,
Associate General Counsel,
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Attorney,
Securities and Exchange Commission.

JANUARY 1962.

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[1] In deference to the attitude of the court below the Commission now phrases releases giving notice of the institution of revocation or denial proceedings in terms which make explicit that it is acting upon the recommendation of the staff, which, as the complainant, has reason to believe that violations have occurred. See, for example, Securities Exchange Act Release Nos. 6666 (November 3, 1961) and 6690 (December 20, 1961).

APPENDIX

SECURITIES EXCHANGE ACT OF 1934

OVER-THE-COUNTER MARKETS

SECTION 15. (b) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

An application for registration of a broker or dealer to be formed or organized may be made by a broker or dealer to which the broker or dealer to be formed or organized is to be the successor. Such application shall contain such information in such detail as to the applicant and as to the successor and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the applicant or the successor, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such regis-

tration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine. Such registration shall terminate on the forty-fifth day after the effective date thereof, unless prior thereto the successor shall, in accordance with such rules and regulations as the Commission may prescribe, adopt such application as its own.

If any amendment to any application for registration pursuant to this subsection is filed prior to the effective date thereof, such amendment shall be deemed to have been filed simultaneously with and as part of such application; except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day after the filing of such amendment.

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made in any application for registration pursuant to this subsection or in any document supplemental thereto or in any proceeding before the Commission with respect to registration pursuant to this subsection any statement which was at the time

and in the light of the circumstances under which it was made false or misleading with respect to any material fact; or (B) has been convicted within ten years preceding the filing of any such application or at any time thereafter of any felony or misdemeanor involving the purchase or sale of any security or arising out of the conduct of the business of a broker or dealer; or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security; or (D) has wilfully violated any provision of the Securities Act of 1933, as amended, or of this title, or of any rule or regulation thereunder. Pending final determination whether any such registration shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing, it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors. Any registered broker or dealer may, upon such terms and conditions as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal

with the Commission. If the Commission finds that any registered broker or dealer, or any broker or dealer for whom an application for registration is pending, is no longer in existence or has ceased to do business as a broker or dealer, the Commission shall by order cancel the registration or application of such broker or dealer.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 585

N. SIMS ORGAN & CO., INC. and N. SIMS ORGAN,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

This petition for certiorari was filed on December 4, 1961. On December 7, 1961, the United States Court of Appeals for the Second Circuit decided two cases, *Berko* v. *S. E. C.*, and *Kahn* v. *S. E. C.* (both as yet unreported in the Federal Reporter), CCH Federal Securities Law Reporter, ¶91,115 and ¶91,116.

In our opinion, the decisions in these cases are in direct conflict with the decision in the case at bar. We refer particularly to the facts as stated at App. pp. A-3-4 and App. pp. B-5-6. These cognate cases were reversals on behalf of two securities salesmen who had been held "causes" in a revocation proceeding against a broker-dealer, MacRobbins & Co., Inc.

Just as in the case at bar, the gravamen of the offenses charged consisted of a single telephone call from the salesman to a customer, in which it was stated that a stock will go up. Judge Marshall said in *Berko*:

> "The SEC's findings boil down to the following propositions. Berko predicted Sports would rise to 15 within a year. There was no adequate basis for this statement because Sports, a firm in business for approximately one year, was suffering initial operating losses. Petitioner should have known of the losses and disclosed them."
>
> * * * *
>
> "The present case however involves the liability of an employee of the firm who exercised no control over its operations and apparently did not engage in a continuous course of fraudulent conduct. Moreover, the findings and apparent legal theory of the Commission itself are not restricted to 'boiler room' operations. The only finding is that Berko made the prediction. The only legal theory is that this statement should have been accompanied by disclosure of the losses and that it lacked an adequate basis. In neither aspect do we find an element peculiar to so-called 'boiler room' operations."

In our opinion, the Court of Appeals for the Second Circuit has overruled its decision in the case at bar. We examined the original briefs on file in the office of the Second Circuit Clerk, and we find that not only was the opinion in the case at bar cited, but it was discussed.

Of course, the inevitable result of an appellate court sitting in groups of three judges is a possibility

of conflicting opinions which cannot be completely resolved by a provision for re-hearing by the sitting judges *en banc*. Yet in the case at bar, one member, Judge Friendly, sat in all three cases—*Berko*, *Kahn*, and *Organ*. Thus, we can only infer that the Second Circuit has overruled itself.

Any petition for re-hearing below is barred by lapse of time, because of the fifteen day limitation in the rules of that court. Nevertheless, when the ultimate result of the affirmance of the SEC's opinion is the barring of the petitioner Organ for life[1] from the only business he ever knew, as a result of a doubtful telephone conversation with a hard-of-hearing, disgruntled customer, this Court should exercise its discretionary jurisdiction and grant certiorari. The Hearing Examiner found that there was no proof of any misrepresentation by Organ (R. 26a-27a).

Answering Respondent's Brief

Attention is directed to page 3 of respondent's brief wherein it is stated: "These activities resulted in revocation of that Company's registration on December 28, 1958 (Pet. App. B-3). See *J. H. Lederer Co.*, 38 S.E.C. 794. Within a month after the revocation, petitioner N. Sims Organ Co. * * * was organized, and application was made thereafter for its registration as a broker and dealer. (Pet. App. B-4)."

A studied attempt upon the SEC's part has been made to create the impression that there was a nefarious plan between Lederer & Co. and Organ to create

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[1] The arguments of the petitioners in *Berko* and *Kahn* were to the same effect, and apparently moved the Second Circuit to reverse.

N. Sims Organ & Co., Inc., after Lederer & Co.'s registration was revoked.

The SEC well knows, as a matter of record, that N. Sims Organ & Co., Inc., was originally incorporated on January 8, 1959, as R. H. Palmer & Co., Inc., by individuals not connected with Organ and who never had any relationship whatsoever with either Lederer or Organ; that when the original incorporating parties decided to abandon the corporate shell, Organ, to save expenses, undertook in September 1959 to take over that shell and to change its name to N. Sims Organ & Co., Inc. At no time since its incorporation as R. H. Palmer & Co., Inc., and prior to the change of name to N. Sims Organ & Co., Inc., had Palmer & Co., Inc., engaged in any business or consummated any transaction.

N. Sims Organ & Co., Inc., was thus actually organized on September 28, 1959, almost one year after the Lederer revocation.

This calculated and brazen attempt by an arm of the government to buttress its weak case by knowingly attempting to create a wrongful inference, diffusing an aura of wrongdoing where none ever existed, merits severe censure.

Attention is called to another inconsistent position adopted by the SEC.

It urges that the initial hearing before the Examiner was one to determine whether the effective date of the broker-dealer Registration should be further postponed pending the denial proceedings (R. 18a).

The actual fact is that the effective date of registration by SEC order, had been extended to December 21, 1959. The hearing on the denial proceeding then commenced, the SEC presenting its witness and evidence.

To substantiate petitioners' contention that the proceeding before the Hearing Examiner was a denial proceeding, reference is made to the Release publicly distributed by the SEC (Commission Brief, pg. 11):

"Fraud charged to N. Sims Organ Co."

"The S.E.C. has issued an order under the Securities Exchange Act postponing the effective date of N. Sims Organ & Co., Inc., 460 E. Park St., Long Branch, L.I., New York, as a broker-dealer *and ordering a hearing on the question whether such registration should be denied* * * *" (emphasis added)

This notice was dated November 23, 1959. The hearing commenced December 2, 1959.

Attention is called to the anomalous fact that N. Sims Organ & Co., Inc., had never actively engaged in any business, yet it had been charged with fraud.

Since the order of the SEC, Mr. Organ has been unable to obtain employment in the only profession in which he is qualified. Mr. Organ's source of income has been lost; he is no longer the support of his family; and he has been the object of charity being unable to pay counsel and other expenses in this proceeding.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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